Bank Secrecy: a Look at Modern Trends from a Theoretical Standpoint

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Abstract

Bank secrecy has long been recognized as one of the fundamental legal constructions in banker-customer relationships. Recent developments in legal regulation of it show that bank secrecy is subject to more and more limitations, i.e. more and more authorized bodies may have access to the relevant information and, moreover, in some cases the banks are obliged to inform the authorities about clients' transactions even without any request. Many scholars consider these developments as a limitation of bank secrecy which eventually may lead to its "death". The author argues that such an assessment is based on a one-sided approach to bank secrecy as a fundamental right of the bank's client. As a general rule, bank secrecy of this nature is understood to be one of the components of an individual's right to privacy, or — in the case of a legal entity — as one of the fundamentals of the legal status of a legal entity. Although such an approach is acceptable within a positivistic view on the legal theory, the author argues that a broader view on the matter is justified when the legal nature of bank secrecy is understood as a legal construction aimed at finding an optimal balance between private and public interests involved in the confidential sphere of banker-customer relationships. As a result the latest developments may be seen as attempts to find a new balance, the balance between private and public law aspects of bank secrecy which will be more adequate taking into consideration the realities of the contemporary banking and financial environment.

Keywords

bank, secrecy, banking law, private interest, public interest, customer.

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It is unlikely to be a mistake to say that the main topic currently discussed with regard to bank secrecy is its limitations: exemptions from the general obligation of the bank to keep its client affairs confidential. Modern law is rich in examples, when bank confidentiality obligations are diminished, and more and more authorized bodies may have access to information within the scope of bank secrecy.

That is true. To illustrate this point let's have a look at some milestones.

The case of the Russian Federation is really remarkable. Initially the Banking Act[1] has listed just several cases when banking secrecy had to be revealed, namely:

- if the client is a legal entity, the data within the scope of banking secrecy could be provided to the client itself, to the courts, to the investigative authorities, arbitration bodies, auditors or financial authorities for the purposes of taxation;

[1] Федеральный закон от 2 декабря1990 г. № 395-1 «О банках и банковской деятельности» // Ведомости СНД и ВС РФ. 6.12.1990. № 27. Ст. 357 / СПС «КонсультантПлюс».

• if the client is a natural person, the data within the scope of banking secrecy could be provided to the clients, the courts and investigative authorities. In both cases, only when the case has been initiated officially and the account balance is under arrest or under the court's enforcement procedures.

That's it. The brevity of the wording of the law has left a lot of space for questions and could be easily criticized for lack of necessary legal accuracy, but this is not our topic — the idea here is to show the very limited number of cases and authorized bodies in relation to which banking secrecy might have been revealed under the mandatory provisions of the law.

If one takes time to have a look at the current version of the law[2], the difference is impressive — the wording of the relevant article covers several printed-out pages. On one hand, it provides more numbers of cases and bodies obliged to keep the data comprising banking secrecy — it includes not only banks, but also bodies authorized under the law to get the relevant information from the banks, and they bear the negative consequences of unlawful release of the respective information equally with the banks. But on the other hand — and this goes to the core of our article — the range of the bodies to which the information comprising banking secrecy may be released, and the range of the cases when it might be released is also multiplied. Now the list of bodies authorized to get the relevant information, apart from the courts and investigative authorities, includes:

- Audit Chamber,
- tax authorities,
- Pension Fund,
- Social Security Fund,
- enforcement authorities (bailiffs),
- other bodies defined by the President in case of inspection in accordance with anti-money-laundering legislation.

It is remarkable that the current version of the law does not even provide a final list of the bodies authorized to get the relevant information from the banks, yet allows for a procedure to be followed for widening the range of authorized authorities — as it was just mentioned with regard to potential money-laundering audits.

It is not our task to go into all the details and practical and theoretical aspects of these changes and developments — the data referred to above is enough to draw conclusion that the obvious trend in Russian banking law is the widening of the cases when, and the bodies to which, the information comprising banking secrecy can be revealed under the mandatory provisions of the law.

But the Russian example is not a unique one in the world of the contemporary banking law. It would not be the right approach for a brief article to go into a detailed comparative analysis of the different legal systems and traditions, so we'll mention just one, although it is the most remarkable example in the field of international banking law — the Directive 2003/48/EC. In respect of the issues within the scope of banking secrecy, this Directive has obligated the banks ("paying agents" in the terminology of the Directive) to provide the competent authorities with a certain amount information in cases of transfer of certain kinds of income ("interest payments" according to the terminology and as defined in the Directive), when the transfer is of cross-border nature, namely, interest payments are to be transferred from the country (Member State) where the bank is located to the beneficiary of the transfer located at another Member State.

[2] Федеральный закон «О банках и банковской деятельности» (ред. от 13.07.2015) / СПС «КонсультантПлюс».

In the case of such a transfer, the bank is obliged to provide the competent authorities with information regarding the identity and residence of the beneficiary of the respective transfer, its account number and information regarding the transfer, including the amount of the transfer[3].

The most remarkable feature of the Directive is that in cases and under circumstances listed in the Directive, the bank is obliged to inform the respective authorities under its own initiative, without any special request for them. This is really a shift of the philosophy of banking secrecy — the information is revealed not when the competent authorities have requested the information in accordance with the laws, but vice versa — the information is revealed because the bank in question does so under its own initiative. If traditionally the bank can be seen as the "keeper" of the client's secrets and opens them only when the authorities request it (subject to the condition that they request it strictly under the laws and in no case otherwise), now it can be seen as a "watchdog" in relation to its client, and, in all cases covered by the Directive, the bank is reporting about the affairs of its client which were traditionally protected by banking secrecy rules. A really impressive shift, indeed! And that was not the end — the negotiations in progress at the official international level regarding the transparency of the information on bank accounts.

As a result there is no shortage of opinions that bank secrecy ceases to exist. Another approach may assess such a development of banking secrecy in a more positive way — if banking secrecy is considered and protected by the law as an absolute value, it may easily transform itself into a "cultural" tool of tax evasion. Like Shelley Stark puts it, "with the use of *Treuhand* accounts with lawyer-trustees protected by attorney-client privilege, the true owners, actors and beneficiaries of financial transactions are successfully hidden from government oversight"[4].

We are not going to share or multiply the views stating, in a more or less categorical way, that the banking secrecy "bites the dust"[5]. And generally, we are not going to keep ourselves within the limits of just a "good or bad" approach. We believe that this remarkable trend which has so clearly (if not sharply) expressed itself in the sphere of banking secrecy is to be valued differently, if we take into account the very nature of this legal construction — banking secrecy — so deeply rooted in the sphere of banking law.

Indeed, banking secrecy has so long been established in the banker-customer relationship that we have started to consider it as a value-in-itself, as something obvious, as one of the imminent features of banker-customer relations. As a result of this traditional approach any development to the contrary is seen as a corruption of banking secrecy and as something which goes against the core of the bank's attitude to its client and even against the core of banking as such. But such an assessment may prove to be wrong if the nature of banking secrecy is seen and assessed not *just* within the limits — however wide — of the banker-customer relationship, but in a wider context of banking law.

First of all, it should be noted that banking secrecy is traditionally developed in different legal systems as a *private law institution*.

Let's take as an example the banking law of England — such an approach would be more than justified if we take into consideration that the banking law of England is the classical

[3] Article 8 of the Directive 2003/48/EC 3 June 3, 2003 On Taxation of Saving Income in the Form of Interest Payments // Official Journal of the European Union. 2003. L 157/38.

[4] *Stark S.* Bank Secrecy: *Treuhaund* accounts obviate new OECD tax evasion rules. // http://www.viennareview.net/news/front-page/banking-secrecy.

[5] The expression which became famous after the article by Andrew Willis in Businessweek under the title "Bank Secrecy Bites the Dust in Europe" // http://www.businessweek.com/globalbiz/content/mar2009/gb20090313_953226.htm/.

example of development of banking law as the private law of banker-customer relations with only subsequent intrusion of public mandatory rules, mostly due to the involvement of the United Kingdom (as a member state of the European Union) into international developments in banking laws.

English banking law has accepted bank secrecy as an implied condition of contract between the bank and its customer. This view is rooted in considering the banker-customer contract as a type of an agent-principal contract, thus the features of agent principal relations are generally applicable to banker-customer relations in a way that is compatible with the peculiarities of those relations. One of the traditional duties of an agent to its principal in English law is the duty of confidentiality. The level of confidentiality might be different in different types of agent-principal relations. For example, in the case of a solicitor and his/her client, the duty of confidentiality is practically absolute. In the case of banker-customer relationships, the duty of confidentiality is qualified. Generally, English banking law provides for the four exceptions applicable to banker-customer relationships, when the bank is allowed or even obliged to release the banking secrecy. This approach has been established in *Tournier v. National Provincial and Union Bank of England* [6], where Bankes LJ has expressed the following:

"On principle, I think the qualifications can be classed under four heads: (a) where disclosure is under compulsion by law; (b) where there is a duty to the public to disclose; (c) where the interests of the bank require disclosure; (d) where the disclosure is made by the express or implied consent of the customer".

For the purposes of our research the most important is the following. Whatever the qualifications to bank secrecy, the English authors are unanimous in understanding of bank secrecy as rooted in the private law of banker-customer relationships, and not imposed by any public law requirements. Like G. Penn and J. Wadsley put it, "Many countries have a statutory law relating to the banker's duties of secrecy. In England the law is judge-made, and based on a term implied into the contract between banker and customer[7]".

Thus, English experts confirm the approach, that banking secrecy is a legal construction of a private law nature — in the case of English law it is an implied condition of a contract between banker and customer, but not a requirement of a statutory nature.

But such a situation cannot be seen as true only in relation to English law, which is more of a judge-made than statutory nature. It may be confirmed, that even in countries where the legal system is based on the law, the nature of banking secrecy is similar — it is not created by any legal act, it is elaborated in the course of private banker-customer relationships and as such may be recognized by an official legal (banking) act.

Let's refer, for example, to an assessment expressed by the Swiss expert — an expert from the country traditionally considered as a citadel for banking secrecy. "Banking and exchange secrecy, which in practice means confidentiality of the information, is based upon the obligations provided for by a private law, in particular implied accessory obligation in accordance with the rules on contracts and agency (p.1 art. 398 of the Obligation Laws Code), as well as on the right of the client on privacy (art. 28 of the Obligation Laws Code)"[8].Taking into consideration the historical development of the Swiss banking system, including the fact that bank

[6] [1924] 1 K.B. 461.

[7] *Penn G.A., Wadsley J.* The Law Relating to the Domestic Banking. L., 2000. P.137. For a similar approach see, for example: *Ellinger E.P., Lomnicka E., Hooley R.J.A.* Ellinger's Modern Banking Law. 4th ed. Oxford: University Press, 2006. P. 165.

[8] *Нобель П.* Швейцарское финансовое право и международные стандарты. М.: Волтерс Клувер, 2007. С. 1011.

secrecy was a well-known feature of the Swiss banking world long before the introduction of the Obligation Laws Code, as well as long before the introduction of criminal sanctions for breach of banking secrecy in the Swiss Federal Banking Act 1934, it is obvious that even in the country with a legal system based on legal enactments and famous for its banking secrecy, the nature of banking secrecy is that of a private law institution, and that private law institution is not imposed by the law, but developed as an implied condition of a contract between banker and customer, and only later may be recognized by a statutory rule.

This approach will be correct also with regard to the other European countries with legal systems based on written and officially enacted laws. For example, Professor C. Gavalda and J. Stoufflet — leading experts in French banking law — expressly state that obligation to keep confidentiality is a traditional obligation of a banker from time immemorial[9]. German experts used to state that in German law "there is no express statutory rule providing that a financial institution shall treat the matters of its customers or of third persons confidentially. Instead of this, the duty to keep such matters confidential is derived from the contractual relationship existing between the financial institution and customer, this relationship implying a generally fiduciary duty"[10]. Italian experts also confirm that Italian banking legislation does not provide for any definition of banking secrecy, and the legal doctrine links banking secrecy either to commercial usage or to the principle of fairness[11]. The same situation is true with regard to the Netherlands[12]. Trust that there are enough examples to prove this approach.[13]

What follows from a situation in which banking secrecy is a private law institution by its nature? We are of the opinion that the vitally important condition of efficiency of a private law institution is finding the correct balance between the private interest represented by this institution, on one hand, and the public interests affected by this institution, on the other. With regard to the legal system in general it may be proven in the general theory of law, but our task is smaller — to show, that this is true regarding bank secrecy[14].

In what way does bank secrecy as a private law institution affect or be affected by public law interests? There are at least two important consequences of this.

Firstly, every time we assess a legal institution in terms of its nature as either a private or public law institution, a correct relation between public and private law aspects is to be kept in mind. It is interesting to note that the answer to the question about the correct relations between these two aspects is given in the very place where the distinction between private and public law is presented, but that aspect is often overlooked. Justinian's Roman law *Institutiones*

[9] *Гавальда К., Стуфле Ж.* Банковское право. М.: Финстатинформ, 1996. С. 101; *Gavalda C., Stoufflet J. et autres*. Le secret professional dans la CEE et la Suisse. Paris, 1973. P. 77.

[10] *Sandrock O., Klausing E.* Germany // European Banking Law: the Banker-Customer Relationship. London, 1993. P. 92.

[11] *Cotterli S.* Italy // European Banking Law: the Banker-Customer Relationship. London,1993. P. 113-114.

[12] *Roelvink J., Lodewijk J.* The Netherlands // European Banking Law: the Banker-Customer Relationship. London, 1993. P. 131-132.

[13] It might be argued, that in Russia banking secrecy has been introduced by the legislation and not developed by commercial usage — that is true, but this does not deny the general situation, because development of the Russian commercial banking system has taken place under quite different circumstances — first the banking laws allowing commercial banking have been introduced, and after that the development started. So, the Russian example is an exemption which just confirms the general rule.

[14] It should be mentioned that with regard to business law in general the idea of counteraction of private and public interests has been addressed in: *Курбатов А.Я.* Соотношение частных и публичных интересов в правовом регулировании предпринимательской деятельности. М.: Юринфор, 2001.

state the distinction between private and public law not as a value *per se*, but in a wider context — a context of justice which is understood as giving to everybody what really belongs to him (*jus suum cuique tribuens*). In this wider context the distinction between private and public law makes sense only to the extent that both private and public aspects of the law are given "what belongs to them", and this is what leads to the true justice.

Secondly, if the first consequence is correct, we are to search for a specific shape of the balance between the private and public interests with regard to bank secrecy. In what sense can bank secrecy be understood as satisfying both private and public interests?

The existence of a private interest in bank secrecy does not require lengthy argumentation — it is obvious, that an individual or a business is naturally interested in keeping his/its banking/commercial affairs in secret.

As for the public interest in bank secrecy, the most frequently mentioned aspect is that it is not to be abused against public interests. In this respect, bank confidentiality is not supposed to play a role of "a cloak for wrongdoing, often on a massive scale," when fraudsters in many shapes and sizes may use the banking system "to spirit away their ill-gotten gains"[15].

That is definitely correct. But this is not the only aspect in which public interest is present in bank secrecy. Apart from this, so to say, "negative" aspect, there is also a positive one — in the case where a banker is not following confidentiality rules in its relations with clients, it will bring substantial damages both to its reputation (with possible losses in clientele) and to the financial system as a whole, because in such a case the trust to the financial system will be lost. Therefore it is in the banker's best interest as a commercial entity to keep the rules of bank secrecy.

This is a really important aspect, and we regret to say that it has not been given proper attention in the doctrine of banking law — in many cases bank secrecy is considered as a value for the customer only[16], but not for the bank.

If we take this into consideration twofold — containing both private law and public law interests of bank secrecy- its nature reveals itself not just as a part of a fundamental right of an individual for privacy (or in case of a commercial client, as one of the fundamentals of its legal status), but more like a legal construction aimed at balancing the public and private interest with regard to the information which goes to the "possession" of a banker in the course of its professional (business) activities. It is not a private interest to keep one's own affairs confidential, but the necessity to get the proper balance of public and private interests with regard to the confidential information which justifies bank secrecy from a standpoint of the legal theory. A look at bank secrecy as a "fundamental right of a client", etc. may be justified only within the narrow limits of a positivistic approach to the law, but fails to satisfy the interest of a researcher at a deeper level.

So, what's going on with bank secrecy in the contemporary legal world? It is not a corruption of this legal construction; not a "death"[17] of bank secrecy. The latest developments may be seen as attempts to find the new balance, the balance between private and public law aspects of bank secrecy which will be more adequate taking into consideration the realities of the contemporary banking and financial environment. Needless to say, this process is not an easy one, and in reality may lead to other disbalance — in this respect we do share the concerns of the respected authors who are talking about destruction of bank secrecy. Our intention in this article

[15] *Cranston R.* Principles of Banking Law. Oxford, 1997. P. 179. See also: *Naylor R.* Hot Money. L., 1987.

[16] See, for example: *Белов В.А.* Банковское право России: теория, законодательство, практика. М., 2000. С. 213–214.

[17] See, for example: *Турбанов А. и др.* Смерть банковской тайны? // Закон. 2014. № 10. С. 19–25.

is a theoretical one — to shift the long established one-sided view on the nature of bank secrecy to a more all-enveloping approach which makes it possible to find a more balanced solution to the contemporary issues of financial markets.

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